



MONTANA LEGISLATIVE BRANCH

Legislative Fiscal Division

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Director
AMY CARLSON

DATE: January 17, 2017

TO: Sen. Scott Sales, Senate President
Rep. Austin Knudsen, House Speaker
Sen. Mark Blasdel, Chair, Senate Tax Committee
Rep. Jeff Essmann, Chair, House Tax Committee
Sen. Fred Thomas, Senate Majority Leader
Rep. Ron Ehli, House Majority Leader
Sen. Jon Sesso, Senate Minority Leader
Rep. Jenny Eck, House Minority Leader

FROM: LFD Revenue Team

RE: General Fund Revenue Forecast Update #1

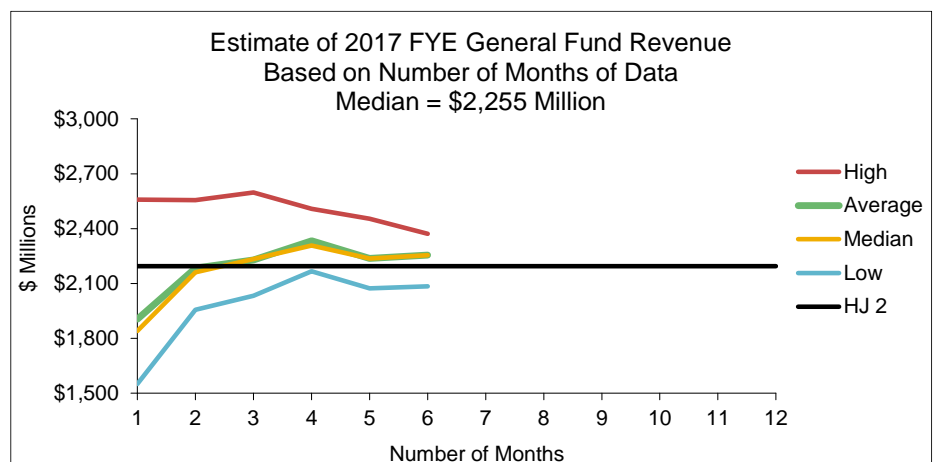
GENERAL FUND REVENUE SUMMARY

This is the first of the monthly revenue forecast updates throughout the 2017 Session designed to brief the legislature on recent economic trends and the corresponding outlook for the 2019 Biennium general fund revenue estimate. This update is based on actual revenue collections received through the end of December 2016, and updated national and Montana forecasts from IHS.

Although FY 2017 general fund revenue through the end of December is \$39.2 million or 3.8% less than FY 2016 and below the anticipated growth of 3.4%, most of the decline is due to a timing issue in property tax collections. In addition, early year-to-date comparisons with FY 2016 will likely be lower due to the odd collection pattern of FY 2016. By the end of February, relative growth is anticipated to be more in line with final FY 2017 expectations.

Year-to-Date Actual Collections Relative to Historical Patterns

As the fiscal year progresses, the accruing data allows for a closer estimate of final collections based on historical collection patterns. Potential total general fund collections for FY 2017 are calculated using various year-to-date percentages—minimum, maximum, median and average—since FY 2002. Note that an adjustment has been made for the property tax timing issue mentioned above. The results are shown in the adjacent chart. Based



on collections through the end of December, the difference between the high and low amounts is about \$287 million, with the average and median values about \$61 million above the HJ 2 estimate.

Forecast Update Based on New Data

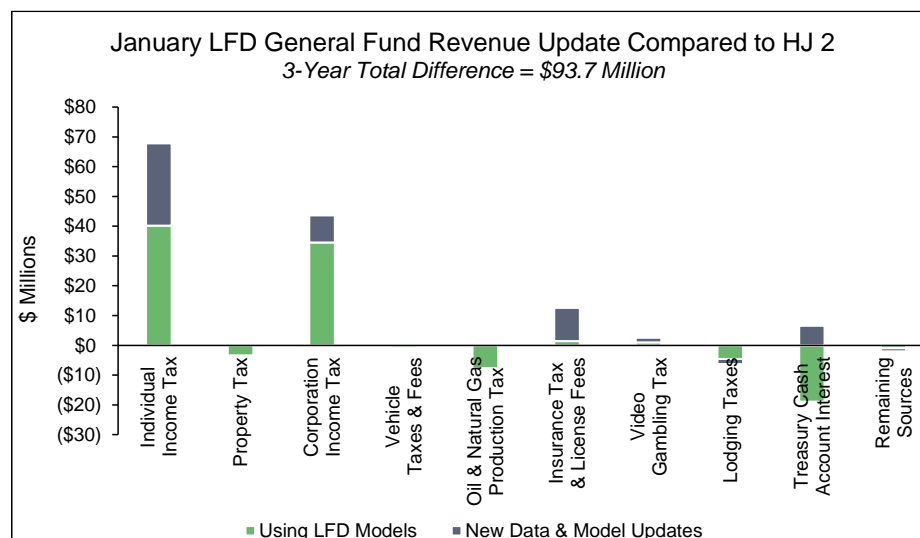
The January economic forecasts from IHS combined with LFD revenue models generates a general fund revenue forecast that is \$93.7 million higher than the official estimate in HJ 2 over the three-year forecast period. The table below shows the HJ 2 estimate and the LFD January update based on revised assumptions.

FY	HJ 2	January Update	\$ Difference	HJ 2 Growth	January Update Growth
2016	\$2,121.3	\$2,121.3			
2017	2,194.3	2,220.0	\$25.7	3.4%	4.7%
2018	2,301.4	2,351.4	50.1	4.9%	5.9%
2019	2,452.6	2,470.6	18.0	6.6%	5.1%
3-Yr	\$6,948.3	\$7,042.0	\$93.7		

The revised forecast from IHS incorporates the following key assumptions:

- Increasing GDP growth, from 1.6% in 2016 to 2.3% in 2017 and 2.6% in 2018—led by gains in consumer spending, business fixed investment and residential investment
- Some policies proposed by the new federal administration, including lower personal and corporate tax receipts to the federal government, consistent with the House Republican plan, as well as \$250 billion in additional infrastructure spending over 10 years
- Higher federal fund interest rate targets of 1.50% by the end of 2017, 2.25% by the end of 2018, and 3.00% by the end of 2019
- Increasing oil prices—West Texas Intermediate (WTI) prices of \$53/bbl in 2017, \$56/bbl in 2018 and \$62/bbl in 2019—lead to renewed growth in US oil production
- Increasing strength of the dollar through 2017, followed by a steady decline through 2026

The LFD January update changes compared to HJ 2 are shown in the graph below, with fiscal year detail provided in the table on the next page. Since HJ 2 is equivalent to the executive November estimate, which was \$40.6 million below the LFD November estimate over the three year estimate period, nearly half of the increase in the LFD January update is due to using LFD revenue models, with the remaining increase due to the improved IHS economic outlook and LFD model revisions.



January LFD Update Summary of Changes from HJ 2 (\$ Millions)				
Revenue Source	FY 2017	FY 2018	FY 2019	3-Yr Total
Individual Income Tax	\$16.1	\$25.6	\$26.1	\$67.8
Property Tax	0.9	(2.9)	(1.4)	(3.4)
Corporation Income Tax	5.6	31.7	6.4	43.7
Vehicle Taxes & Fees	1.9	0.2	(3.0)	(0.9)
Oil & Natural Gas Production Tax	1.7	(1.8)	(7.9)	(8.0)
Insurance Tax & License Fees	2.7	3.7	6.2	12.6
Video Gambling Tax	0.0	0.5	2.0	2.6
Lodging Taxes	(1.0)	(2.2)	(3.2)	(6.3)
Treasury Cash Account Interest	(1.4)	(3.9)	(7.0)	(12.3)
Remaining Sources	(0.8)	(1.1)	(0.1)	(2.0)
General Fund Total	25.7	50.1	18.0	93.7
Guarantee Fund	(0.0)	(0.4)	(2.0)	(2.4)
General Fund & Guarantee Fund Total	\$25.6	\$49.6	\$16.0	\$91.3

NEXT STEPS

Updated revenue forecasts will be published monthly throughout the 2017 Session. The next report will be available in mid-February. Year-to-date analysis in February should give a clearer perspective on the outlook for FY 2017, since the timing issues with property tax and individual income tax collections will be corrected by the end of January.

In addition, new data will be available and incorporated into the LFD February general fund revenue forecast update. Key sources of new data include the following:

- IHS National & Montana economic forecasts
- IHS reports and analysis
- SABHRS revenue collection data through January
- Board of Oil & Gas production data
- Department of Revenue detailed collection data through January

YEAR-TO-DATE GENERAL FUND REVENUE

FY 2017 general fund revenue through the end of December is \$39.2 million or 3.8% less than FY 2016 revenue through the same period; this decrease is below the HJ 2 estimated increase of 3.4%. Most of the decline in revenue is due to a timing issue in property tax collections, which should clear up next month.

General Fund Revenue Monitoring Report (\$ Millions)							
Revenue Source	Actual FY 2016	HJ 2 Est. FY 2017	HJ 2 Est. % Change	YTD FY 2016	YTD FY 2017	YTD Difference	YTD % Change
Largest Seven Sources							
Individual Income Tax	\$1,184.828	\$1,219.776	2.9%	\$658.968	\$652.708	(\$6.260)	-0.9%
Property Tax	257.100	260.150	1.2%	111.096	75.401	(35.695)	-32.1%
Corporation Tax	118.387	140.308	18.5%	72.319	67.427	(4.893)	-6.8%
Vehicle Taxes & Fees	108.480	109.200	0.7%	46.644	46.586	(0.058)	-0.1%
Oil & Natural Gas Taxes	39.083	44.821	14.7%	-	-	-	
Insurance Tax	69.255	71.102	2.7%	27.962	31.790	3.828	13.7%
Video Gaming Tax	60.554	62.522	3.3%	15.438	14.902	(0.536)	-3.5%
Other Business Taxes							
Drivers License Fee	4.345	4.539	4.5%	2.242	1.735	(0.507)	-22.6%
Investment Licenses	7.212	7.433	3.1%	0.770	0.804	0.034	4.4%
Lodging Facilities Sales Tax	21.493	22.978	6.9%	9.965	9.482	(0.483)	-4.8%
Public Contractor's Tax	2.397	2.510	4.7%	2.920	3.198	0.277	9.5%
Railroad Car Tax	3.594	3.437	-4.4%	3.110	4.235	1.125	36.2%
Rental Car Sales Tax	3.878	3.282	-15.4%	1.995	1.394	(0.601)	-30.1%
Retail Telecom Excise Tax	16.775	16.165	-3.6%	4.399	3.827	(0.572)	-13.0%
Other Natural Resource Taxes							
Coal Severance Tax	14.236	13.225	-7.1%	4.366	5.795	1.429	32.7%
Electrical Energy Tax	4.536	4.595	1.3%	1.192	1.167	(0.025)	-2.1%
Metal Mines Tax	4.221	4.129	-2.2%	0.000	(0.103)	(0.103)	-219946.3%
U.S. Mineral Leasing	16.759	19.610	17.0%	10.022	5.618	(4.405)	-43.9%
Wholesale Energy Trans Tax	3.516	3.502	-0.4%	0.913	0.915	0.002	0.2%
Other Interest Earnings							
Coal Trust Interest Earnings	20.722	19.893	-4.0%	7.263	8.785	1.522	21.0%
TCA Interest Earnings	3.961	5.802	46.5%	1.320	2.184	0.865	65.5%
Other Consumption Taxes							
Beer Tax	3.027	3.029	0.0%	1.331	1.320	(0.011)	-0.8%
Cigarette Tax	31.103	30.980	-0.4%	15.360	14.527	(0.832)	-5.4%
Liquor Excise Tax	19.776	20.596	4.1%	8.372	8.766	0.395	4.7%
Liquor Profits	11.000	11.777	7.1%	-	-	-	
Lottery Profits	11.963	11.549	-3.5%	2.417	3.267	0.850	35.2%
Tobacco Tax	6.184	6.329	2.4%	2.736	2.763	0.027	1.0%
Wine Tax	2.373	2.412	1.6%	1.029	1.069	0.040	3.9%
Other Sources							
All Other Revenue	41.420	42.518	2.7%	14.613	16.825	2.212	15.1%
Highway Patrol Fines	4.040	4.187	3.6%	1.628	1.675	0.048	2.9%
Nursing Facilities Fee	4.764	4.526	-5.0%	1.188	1.140	(0.048)	-4.1%
Public Institution Reimbursement	16.910	14.083	-16.7%	2.647	5.814	3.167	119.6%
Tobacco Settlement	3.394	3.371	-0.7%	-	0.010	0.010	
Largest Seven Subtotal	1,837.687	1,907.880	3.8%	932.428	888.813	(43.615)	-4.7%
Remaining Sources Subtotal	283.601	286.457	1.0%	101.796	106.213	4.416	4.3%
Grand Total	\$2,121.288	\$2,194.337	3.4%	\$1,034.224	\$995.026	(\$39.199)	-3.8%

LFD JANUARY REVENUE UPDATE DETAIL BY MAJOR SOURCE

Individual Income Tax

Individual income tax collections through the end of December are \$6.3 million or 0.9% below the year-to-date collections in FY 2016. The decline in estimated payments likely reflects the lower CY 2015 capital gains income relative to CY 2014.

Individual Income Tax (\$ Millions)				
	YTD 2017	YTD 2016	\$ Difference	% Difference
Withholding	\$426.1	\$415.7	\$10.4	2.5%
Estimated Payments	118.8	131.1	(12.3)	-9.4%
Current Year Payments	19.2	19.4	(0.1)	-0.7%
Audit, P&I, Amended	15.0	19.9	(4.9)	-24.4%
Refunds	(76.4)	(75.3)	(1.1)	1.5%
Refund Accrual Reversal	143.0	140.0	2.9	2.1%
Partnership Income Tax	4.9	5.3	(0.4)	-7.7%
Mineral Royalties	2.1	2.8	(0.7)	-25.2%
Total	\$652.7	\$659.0	(\$6.3)	-0.9%

Cumulative withholding growth dropped from 4.4% at the end of November to 2.5% through the end of December; however, this decline is likely primarily due to a timing issue, as Department of Revenue did not process any payments on the last Friday of December while the tax processing software GenTax was upgraded. Withholding accounts for over two-thirds of individual income tax and about one-third of total general fund revenue, so it will be monitored closely as the year progresses.

The LFD January update for individual income tax is above the three-year HJ 2 estimate by \$67.8 million, with LFD revenue models accounting for \$40.2 million of the difference. The remaining difference is due to the January IHS improved outlook for wage disbursements, interest rates, corporate profits and stock market growth, as well as updated taxpayer data from the Department of Revenue.

Property Tax

Property tax collections are below last year by \$35.7 million or 32.1%. This is primarily due to a lag in property tax bills, and subsequently, tax collections. This lag was caused by the need for adjustments from the NorthWestern Energy property tax settlement that lowered NorthWestern's market value from \$2.6 billion to \$2.4 billion. It is expected that property tax collections will come more in line with HJ 2 expectations next month.

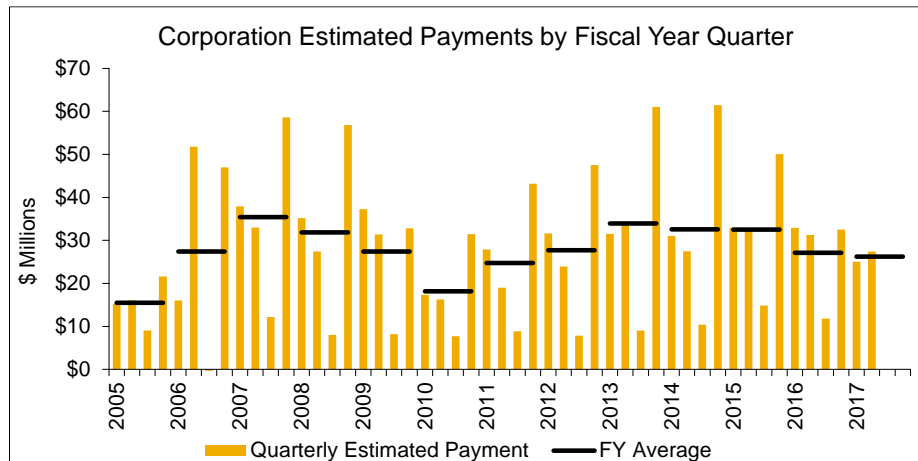
The property tax estimate does not use IHS data, so the three-year decrease of \$3.4 million relative to HJ 2 is due to using LFD estimate models.

Corporation Income Tax

Corporation income tax collections through the end of December are 6.8% or \$4.9 million below this time in FY 2016. Lower estimated payments in FY 2017 have been partially offset by higher audits and lower refunds as shown in the adjacent table. Estimated payments typically account for about 80% of total corporation income tax revenue.

Corporation Income Tax (\$ Millions)				
Account	YTD 2017	YTD 2016	\$ Difference	% Difference
Corporation Tax	\$12.1	\$10.6	\$1.5	14.1%
Estimated Payments	52.5	64.2	(11.7)	-18.3%
Refunds	(7.4)	(9.1)	1.7	-18.7%
Refund Accrual Reversal	3.8	4.3	(0.5)	-12.1%
Audit, P&I, Amended	6.5	2.3	4.2	181.6%
Total	\$67.4	\$72.3	(\$4.9)	-6.8%

The following chart shows that estimated payments in the first two quarters of FY 2017 were below the estimated payments collected in the first two quarters of FY 2016. However, the fourth quarter estimated payments in FY 2016 were significantly lower than any fourth-quarter collections since FY 2010. It is likely that FY 2017 fourth quarter payments will rebound from the FY 2016 low.



The LFD January update for corporation income tax is above the three-year HJ 2 estimate by \$43.7 million. The LFD revenue models account for \$34.6 million of the difference. The remaining difference is due to the January IHS improved outlook for median home price, which resulted in a higher estimate for financial sector tax liability.

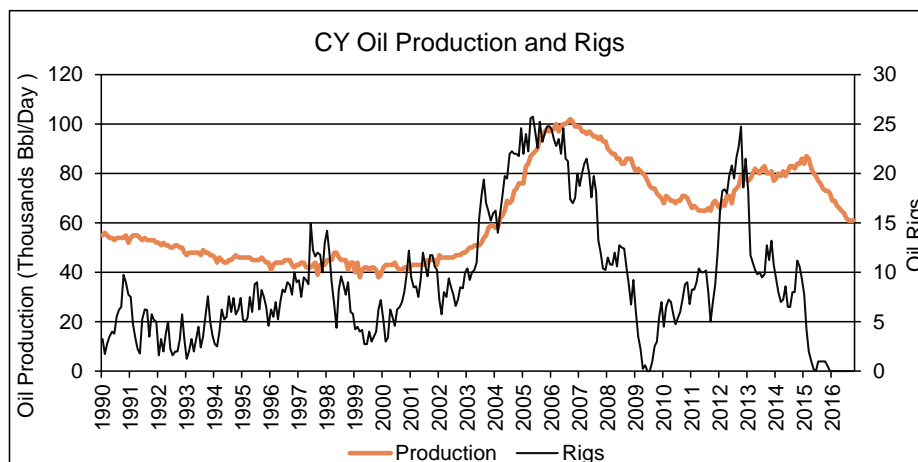
Vehicle Fees & Taxes

Six months into FY 2017, vehicle taxes and fees are 0.1% or \$0.1 million below collections last year at this time. In HJ 2, this source was expected to grow by 0.7%.

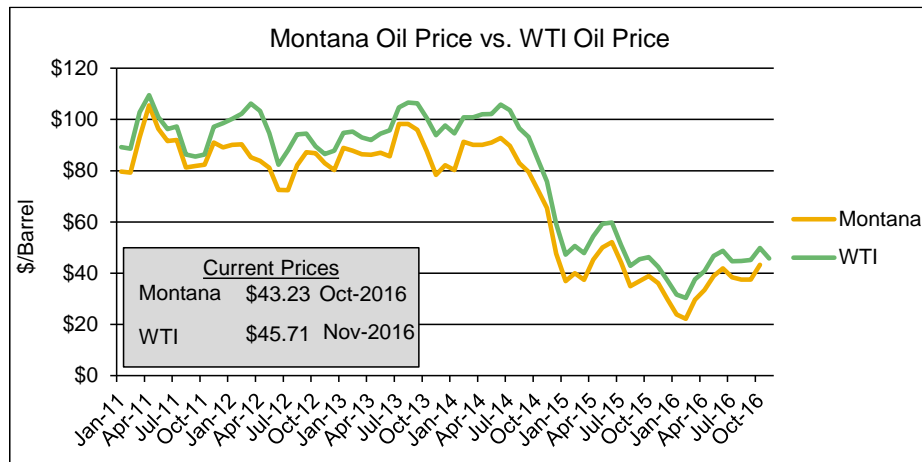
The January IHS forecast had a small positive impact on the vehicle fees & taxes estimate, but primary reason for the three-year decrease of \$0.9 million relative to HJ 2 is using LFD estimate models.

Oil & Natural Gas Production Tax

Oil and natural gas production tax collections show \$0 through December. This is expected due to the statutory requirement of when taxes are due and the time allowed for the Department of Revenue to determine the distribution of taxes to local governments. Known price data suggests that collections for the first quarter of FY 2017 will be below levels in FY 2016, but second quarter prices in FY 2017 were higher than in FY 2016. Second quarter prices, coupled with higher forecast taxable production, should partially offset the decrease experienced in the first quarter.



As the previous chart shows, oil production has been declining since the beginning of 2015, as there has been at most one rig operating in the state since early 2015. The figure below shows Montana's historical oil price compared to West Texas Intermediate (WTI) oil price.



The LFD January update for oil & natural gas taxes is below the three-year HJ 2 amount by \$8.0 million. Nearly all of the difference—\$7.7 million—can be attributed to using LFD models. The January IHS outlook for oil price increased by over \$2/bbl in 2017 and edged up in the other outlook years, but the increase in price was dominated by the faster-than-anticipated decline in production.

Insurance Tax

Current insurance tax collections are 13.7% or \$3.8 million above FY 2016 through December. About half of the increase is from the premiums insurance account, in which collections are growing strongly—7.3% over FY 2016 through the first two quarters. The other half of the increase is due to two large monthly collections in the fire marshal taxes account, which typically doesn't receive significant revenue until after January. According to staff at the State Auditor's Office (SAO), under new rules (see [ARM 6.6.4801](#) to [ARM 6.6.4803](#)), some companies owed additional fire premium tax, which was collected in the first half of FY 2017.

The LFD January update for insurance tax is above the three-year HJ 2 amount by \$12.6 million. A small portion—\$1.4 million—is due to using LFD modeling. Of the remaining \$11.2 million, just over half is due to incorporating additional future fire premium taxes and the rest is due to an improved IHS outlook for consumer expenditures in the finance and insurance sector.

Video Gambling Tax

Revenue from video gambling is currently \$0.5 million or 3.5% below collections from last year. The LFD January update for video gambling tax is above the three-year HJ 2 amount by \$2.6 million, with LFD revenue modeling accounting for \$1.0 million of the increase. The January IHS forecast had a stronger outlook for Montana personal income, which increased the estimate by \$1.6 million over the three year period.

Lodging Facilities Sales Tax

Year-to-date lodging facilities sales tax collections are below FY 2016 by \$0.5 million or 4.8%, and below the 6.9% growth anticipated in HJ 2. The January IHS lower outlook for national consumer spending on accommodations had a small negative impact on the lodging facilities sales tax estimate, but primary cause of the \$6.3 million three-year decrease relative to HJ 2 is the use of the LFD revenue model for this source.

TCA Interest Earnings

TCA interest earnings are currently \$0.9 million or 65.5% above FY 2016, and above the 46.5% growth contained in HJ 2. The January IHS higher outlook for short term interest rates had a \$6.6 million positive

impact on the TCA interest earnings estimate, but primary cause of the \$12.3 million three-year decrease relative to HJ 2 is using the LFD revenue model, which adjusts for the historical over-estimating statistical bias of the IHS short-term interest rate forecasts.

Remaining Sources

Revenue from the remaining sources was 4.5% above FY 2016, primarily due to timing. Half of the combined three-year decrease of \$2.0 million for the LFD January update relative to HJ 2 is due to using LFD revenue models. The January IHS forecast resulted in very small changes—both positive and negative—to most of the remaining sources. In aggregate, the new data resulted in a decrease of \$1.0 million over the three-year period.

Guarantee Fund

The LFD January update for the guarantee fund is below the three-year HJ 2 amount by \$2.4 million. New information from the Board of Investments on the expected rate of return is the primary driver of the difference with respect to HJ 2.